

## ANALYSIS OF AMENDED BILL

Author: Wesson Analyst: Jeani Brent Bill Number: AB 41  
Related Bills: See Legislative History Telephone: 845-3410 Amended Date: 4/05/1999  
Attorney: Doug Bramhall Sponsor: \_\_\_\_\_

**SUBJECT:** Allow Cash Bond Payments & Preserve Taxpayers' Right To Raise New Grounds/  
Employer Wages Paid to Qualified TV or Movie Studio Employees Credit

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended \_\_\_\_\_.

☒ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

☒ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended \_\_\_\_\_.

FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO \_\_\_\_\_.

☒ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED/AMENDED \_\_\_\_\_ STILL APPLIES.

☒ OTHER - See comments below.

### SUMMARY OF BILL

This bill would allow taxpayers to make a deposit in the nature of a "cash bond" to stop the running of interest and still preserve the taxpayer's right to raise new grounds disputing the validity of an assessment.

Under the Bank and Corporation Tax Law (B&CTL), this bill would provide a credit equal to 30% of cost of training and employment of qualified employees, as defined, engaged in the production and/or distribution of motion pictures, videos, television programs, or commercials.

### SUMMARY OF AMENDMENT

The March 17, 1999, amendments added the provisions regarding the employment and training tax credit. This provision will be discussed in this analysis.

The April 5, 1999, amendments modified both the cash bond and employment and training tax credit as follows:

Deleted the right to bring action for refunds from the cash bond provision and added a right to raise new grounds when disputing the validity of a deficiency assessment. Made various technical and substantive changes to the employment and training tax credit.

The April 5, 1999, amendments resolved the constitutional considerations in the department's analysis of the bill as introduced December 7, 1998. The current law discussion regarding cash bonds in the department's prior analysis still applies in addition to the current law discussion below. The remainder of that analysis is replaced with the following.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Gerald Goldberg

4/21/1999

## CASH BOND

### EFFECTIVE DATE

As a tax levy, this bill would become effective immediately upon enactment and the cash bond provisions would apply to payments made on or after that date.

### LEGISLATIVE HISTORY

AB 1469 (1998) was identical to the cash bond provision of this bill, as introduced on December 7, 1998. The Governor vetoed AB 1469 for an item unrelated to cash bonds. AB 1392 (1999), a similar bill, would allow a taxpayer to bring an action to determine the validity of a tax by posting a bond to guarantee payment of the amount due.

### SPECIFIC FINDINGS

**Under current state law**, if the department determines that the tax disclosed by the taxpayer is less than the tax disclosed by the department's examination of the taxpayer's return, it mails a notice of proposed assessment (NPA) to the taxpayer. By law, each NPA must set forth the reasons for the proposed deficiency assessment and the computation of the deficiency. It is departmental policy to sufficiently inform taxpayers as to the basis of an NPA. Often the department sends schedules and other letters detailing the adjustments that produced the NPA.

If the taxpayer disagrees with the proposed assessment, a protest stating the grounds upon which the protest is based must be filed with the department in writing within 60 days.

Upon receipt of the protest, the department reviews its information, including any additional information received with the protest. Under departmental policy, the taxpayer and staff are allowed to raise new issues during the protest. After reaching a decision based on the review, the department sends the taxpayer a notice of action (NOA) that withdraws, revises, or affirms the NPA.

A taxpayer that disagrees with the NOA may appeal the department's action on the protest to the Board of Equalization (BOE) within 30 days. The appeal must be in writing and include any supporting documents. To determine the appeal, the BOE requires written statements or briefs and, upon request of the taxpayer, an oral hearing. During the appeal process, departmental policy follows BOE's general practice. The taxpayer and staff are allowed to raise new issues. However, if staff raises a new issue, the burden of proof shifts to the department in that area. Under current BOE rules, the department has approximately 90 days to file its opening brief with the BOE and 30 days, or less, to reply to any additional statements the taxpayer may have filed with the BOE.

After the BOE makes a determination, the determination becomes final after 30 days unless the taxpayer or department files a petition for rehearing, which the BOE has discretion in granting. Upon a rehearing, the determination of the BOE is final. At the conclusion of the administrative hearing process, if the taxpayer disagrees with the assessment, the taxpayer may pay the amount due and file a claim for refund.

If the claim for refund is denied or the department has not taken action on the claim for six months, the taxpayer may bring a suit for refund in Superior Court. The department may not appeal or file a Superior Court action following an adverse decision by the BOE.

A taxpayer can file a claim for refund of an overpayment at anytime within the applicable statute of limitations. California law requires the taxpayer to state the specific grounds upon which a claim is made.

In reviewing any claim for refund, the department evaluates the taxpayer's grounds and issues an NOA allowing, revising, or disallowing the claim for refund. If the department fails to issue an NOA within six months, the claim is deemed denied.

A taxpayer that disagrees with the department's action may appeal to the BOE<sup>1</sup> or file a suit for refund in Superior Court within 90 days stating the basis of the disagreement. Case law is clear that, for purposes of claims for refund, taxpayers may not raise new issues, beyond those raised as the basis for the refund claim, after the statute of limitation has expired.

If, after filing a protest with the department or filing an appeal with the BOE, a taxpayer pays the tax before the department acts upon the protest, or before the BOE acts upon the appeal, the protest or appeal is treated as a claim for refund or an appeal from the denial of a claim for refund. Where a protest or appeal is converted in this manner, the grounds for the claim are those stated in the taxpayer's protest or appeal. For protests or appeals converted to claims for refund, the BOE may allow taxpayers to raise new issues. However, the department is precluded from auditing the converted claim with respect to the new reason for the claim. In this instance, the burden of proof rests with the taxpayer concerning the new issue. However, if the taxpayer satisfies the burden of proof, the department may not have adequate time to provide factual or legal analysis of the new issue since the department is limited to the BOE appeal procedure time frames (generally 90 days to respond to an opening brief and 30 days to respond to a supplemental brief).

**This bill** would allow a taxpayer to designate a payment of taxes as a deposit in the nature of a cash bond to stop the running of interest and preserve the taxpayer's right to raise new grounds disputing the validity of a deficiency assessment until the conclusion of a BOE hearing on a proposed deficiency.

**This bill** also would require the department to promulgate rules and regulations to adopt provisions of federal Revenue Procedure 84-58, 1984-2 C.B. 501.

#### Policy Considerations

The cash bond provision would raise the following policy considerations.

1. Although taxpayers currently are allowed to raise new issues when appealing the department's action on their protest to the BOE, this bill could delay the appeals process to the extent that more taxpayers present

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<sup>1</sup> Taxpayers that appeal the department's action on a protest to the BOE and receive an adverse determination, cannot appeal the denial of a claim for refund to the BOE. Instead, they must file a suit for refund in Superior Court.

their grounds for dispute before the BOE or taxpayers present their grounds one at a time, creating a 30-day delay each time.

2. Disputes are handled most efficiently at the lowest level of review; thus, taxpayers should be encouraged to present their issues as soon as possible.
3. Under the federal system a deficiency can be challenged in the Tax Court, and actions for refund are heard in a U.S. District Court or the U.S. Claims Court. The cash bond procedure permits a taxpayer to preserve the existence of an unpaid deficiency to permit litigation in Tax Court. Under the California system, only suits for refund and actions to determine residence can be litigated in court. Thus, the primary reason that taxpayers use the federal cash bond procedure does not exist for California tax disputes.

#### Implementation Considerations

This provision essentially would codify current practice. Under current practice, taxpayers can make voluntary payments to stop the running of interest, and they can raise new issues before the BOE.

#### Technical Considerations

This bill would raise the following technical considerations. Department staff is available to assist the author with any necessary amendments.

1. It is unclear whether this bill would allow the taxpayer to post a cash bond for an amount less than the full deficiency amount. If the purpose of the bill is to give taxpayers the right to raise new issues, it is unclear whether the bond is necessary.
2. This bill would require the department to promulgate rules and regulations to adopt provisions of federal Revenue Procedure 84-58 (1984-2 C.B. 501). Revenue Procedure 84-58 contains rules and procedures relating to items other than payments in the form of cash bonds to stop the accrual of interest. It is unclear whether this bill would require the adoption of rules relating to the other issues in Revenue Procedure 84-58.

#### FISCAL IMPACT

##### Departmental Costs

Once the implementation concerns are resolved, the cash bond provision should not significantly impact the department's costs.

### Tax Revenue Estimate

The cash bond provision would not result in significant revenue change overall. It is projected that the amount of interest not received in any given year from the posting of cash bonds would approximately equal the savings in interest payments by the department in cases where taxpayers ultimately prevail.

### BOARD POSITION

Pending.

At its March 23, 1999, meeting, the Franchise Tax Board voted 2-0 to take a neutral position on the cash bond provision of this bill as introduced December 7, 1998. The Board has not had the opportunity to review the April 5, 1999, amendments.

### EMPLOYMENT AND TRAINING TAX CREDIT

#### EFFECTIVE DATE

As a tax levy, this bill would become effective immediately and the employment and training tax credit provisions would apply to income years beginning on or after January 1, 1999.

#### LEGISLATIVE HISTORY

AB 358 and AB 484 (1999) are similar to this provision. AB 358 would provide a credit equal to 10% of qualified wages and salaries paid to employees and contractors retained in connection with the production of a television program or motion picture produced entirely in California. AB 484 would allow taxpayers engaged in the production, development or distribution of motion picture and television production to claim a refundable credit equal to 6% of specified production labor contract costs of qualified property.

#### SPECIFIC FINDINGS

**Existing state and federal laws** allow a taxpayer to deduct expenses paid or incurred in the ordinary course of a taxpayer's business (e.g., employee wages and benefits).

**Existing state law** provides various tax credits designed to provide tax relief for taxpayers who must incur certain expenses (e.g., renter's credit) or to influence behavior, including business practices and decisions (e.g., research credits). For instance, taxpayers engaged in a trade or business in an economic development area are allowed a hiring credit for a certain percentage of qualified wages paid to qualified employees.

**This bill** would provide a credit equal to 30% of the wages and salaries paid for the training and employment of qualified employees engaged in the production and/or distribution of motion pictures, videos, television programs, or commercials. The credit would be available for the first 36 months of the qualified employee's employment.

**This bill** would define "qualified employee" as an individual who meets any one of the following criteria:

1. Eligible for or a recipient of unemployment insurance and is below the federal poverty level.
2. A single parent whose gross household income does not exceed \$26,500, with one or more children in the household.
3. Immediately preceding employment with the taxpayer, was:
  - A. Eligible for or a recipient of any one of the following:
    - 1) California Work Opportunity and Responsibility to Kids (CalWORKs).
    - 2) Greater Avenues for Independence (GAIN).
    - 3) Federal Supplementary Security Income.
    - 4) State and local general assistance.
  - B. An economically disadvantaged individual 18 years of age or older.
  - C. A dislocated worker who was long-term unemployed and has limited opportunities for employment or reemployment in the same or similar occupation in the area in which the individual resides.
  - D. An individual who was any one of the following:
    - 1) A disabled individual eligible for or enrolled in or who has completed a state rehabilitation plan.
    - 2) A service-connected disabled veteran.
    - 3) A veteran of the Vietnam era.
    - 4) A veteran who separated from military service within 10 years of commencement of employment with the taxpayer.

**This bill** would require the taxpayer to obtain from the Employment Development Department (EDD), the local CalWORKs office, or social services agency, as appropriate, a certification that a qualified employee meets the above criteria. The taxpayer would be required to retain a copy of this certificate and provide it upon request to the department.

**The bill** would require EDD to develop a form for the purpose of certifying qualified employees.

**This bill** would provide an indefinite carry forward of any excess credit. Since this bill does not specify otherwise, this credit would not reduce regular tax below tentative minimum tax for purposes of alternative minimum tax.

#### Policy Considerations

The employment and training tax credit provisions would raise the following policy considerations.

1. Most wage-based incentive credits in existing law define qualified wages as a percent of minimum wage, rather than allowing credit computations based upon the full amount of employment and training costs.
2. Incentives typically are designed to encourage future behavior. This bill would give a credit for employment and training costs already paid (from January 1, 1999) and for employees currently employed in the production of movies or television programs.

Conflicting tax policies come into play whenever a credit is provided for an expense item for which preferential treatment already is allowed in the form of an expense deduction or depreciation deduction. This bill

would have the effect of providing a double benefit for deductible employment and training costs. On the other hand, making an adjustment to limit deductions or reduce basis in order to eliminate the double benefit creates a state and federal difference, which is contrary to the state's general conformity policy.

3. In addition, this bill would allow taxpayers located within an enterprise zone to claim both this credit and the enterprise zone hiring credit based on the same wage. The enterprise zone credit provisions do not restrict the taxpayer to one credit based upon a single employee.
4. This bill does not specify a repeal date or limit the number of years for the carryover. Credits typically are enacted with a repeal date to allow the Legislature to review their effectiveness. However, once a repeal date has been added and the unlimited credit carryover is allowed, the department would be required to retain the carryover on the tax forms indefinitely. Recent credits have been enacted with a carryover limit since experience shows credits are typically used within eight years of being earned.

#### Implementation Consideration

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the department's normal annual update.

#### Technical Consideration

Pursuant to discussions with the author's staff, the attached amendments would reorganize subdivision (a) of Section 23655 for clarification purposes and would include language to provide the credit under the Personal Income Tax Law.

### FISCAL IMPACT

#### Departmental Costs

The employment and training tax credit provisions would not significantly impact the department's costs.

#### Tax Revenue Estimate

Revenue losses under the PIT and B&CT laws are estimated to be as follows:

Effective Tax Years After December 31, 1998 Assumed Enactment After June 30, 1999 (\$ Millions)			
1999-0	2000-1	2001-2	2002-3
(\$1)	(\$3)	(\$5)	(\$7)

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

#### Tax Revenue Discussion

The revenue impact of providing wage tax credit for the movie/video-production industry would depend on the qualified wage, the turnover rate of the hired, and the tax liability of qualified employers.

Qualified wage is the product of the number of qualified employees hired and the average wage per employee. Recent California employment data for NAICS codes 512110 and 512191 are not available. However, SIC Code 781 is a close approximation of these two NAICS codes. The California Employment Development Department (EDD) provides total employment for SIC 781 (Motion Picture and Video Tape Production) for 1998 as 143,300. The following assumptions were made:

- The employee turnover rate for this industry is 5%.
- Employment in this industry will continue to grow at the same annual growth rate as the last three years, 6.6%.
- The number of qualified employees hired is 5% of the number of job turnovers and new growth.
- The number of qualified-veterans hired accounts for 10% of the total qualified employees hired.

Specifically, the number of qualified employees hired for 1999 is projected to be 855:

$$[143,300 * 1.066 * 0.05 * 0.05 + (143,300 * 1.066 - 143,300) * 0.05] = 855$$

Out of these 855 employees, 85 are veterans ( $855 * 0.10$ ), and the remaining 770 are non-veterans.

The average wage of non-veteran qualified employees is assumed to be about 20% higher than the minimum wage for 1999 (\$6.93/hour, 30 hours/week, and 50 weeks/year). The average wage of qualified veterans is assumed to be three times higher as veterans are assumed to have higher skills than others. Future wages are projected to grow at the same annual growth rate of wages of this industry in the last three years, 6.6%.

It is assumed that 75% of qualified employees will remain in the job after one year. Furthermore, it is assumed that 50% of the generated credit is used each year by employers. Finally, first-year qualified wages are discounted by one half to account for the fact that not all employees are hired on the first day of the year. Only calendar filers (71% of total) are assumed to qualify for this credit in the first year, 1999.

The revenue loss for 1999, the first taxable year of wages paid, is projected to be \$0.6 million ( $855 \text{ employees} * \$12,457/\text{year} * 0.30 * 0.50 * 0.50 * 0.71$ ).

#### BOARD POSITION

Pending.

The Board position for the employment and training tax credit provision is pending.



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FRANCHISE TAX BOARD'S  
PROPOSED AMENDMENTS TO AB 41  
As Amended April 5, 1999

AMENDMENT 1

On page 2, line 27, after "SEC. 2." insert:

Section 17053.55 is added to the Revenue and Taxation Code, to read:

17053.55. (a) There shall be allowed as a credit against the "tax," as defined in Section 23036, an amount equal to 30 percent of the amount paid or incurred by the taxpayer during the income year for wages and salaries paid to a qualified employee for the cost of training and employment. The credit provided by this section is available only for the first 36 months of the qualified employee's employment with the taxpayer.

(b) For purposes of this section, "qualified employee" means an individual who is engaged in work activities that are described in Codes 512110 and 512191 of the North American Industry Classification System Manual, published by the United States Office of Management and Budget, 1997 edition and who meets any of the following requirements:

(1) Is eligible for or a recipient of California State Unemployment Insurance and below the federal poverty level.

(2) Is a single parent whose annual gross household income does not exceed twenty-six thousand five hundred dollars (\$26,500) with one child or more in the household.

(3) Immediately preceding the employee's commencement of employment with the taxpayer, was a person eligible for or a recipient of any of the following programs or benefits:

(A) California Work Opportunity and Responsibility to Kids (CalWORKs) .

(B) Greater Avenues for Independence Act of 1985 provided for pursuant to Article 3.2 (commencing with Section 11320) of Chapter 2 of Part 3 of the Welfare and Institutions Code, or its successor.

(C) Federal Supplementary Security Income.

(D) State and local general assistance.

(4) Immediately preceding the qualified employee's commencement of employment with the taxpayer, was an economically disadvantaged individual 18 years of age or older.

(5) Immediately preceding the qualified employee's commencement of employment with the taxpayer, was a dislocated worker who was long-term unemployed, and has limited opportunities for employment or reemployment in the same or a similar occupation in the area in which the individual resides, including an individual 55 years of age or older who may have substantial barriers to employment by reason of age.

(6) Immediately preceding the qualified employee's commencement of employment with the taxpayer, was a disabled individual who was eligible for or enrolled in, or has completed a state rehabilitation plan or is a service-

connected disabled veteran, veteran of the Vietnam era, or veteran who separated from military service within 10 years of commencement of employment with the taxpayer .

(c) The taxpayer shall do both of the following:

(1) Obtain from either the Employment Development Department, as permitted by federal law, or the local county or city CalWORKs office or social services agency, as appropriate, a certification that provides that a qualified employee meets the eligibility requirements specified in subdivision (b). The Employment Development Department may provide preliminary screening and referral to a certifying agency. The Employment Development Department shall develop a form for this purpose.

(2) Retain a copy of the certification and provide it upon request to the Franchise Tax Board.

(d) In the case where the credit allowed under this section exceeds the "tax," the excess may be carried over to reduce the "tax" in the following year, and succeeding years if necessary, until the credit has been exhausted.

SEC. 3.

#### AMENDMENT 2

On page 3, line 2, before "for" insert:

to qualified employees

#### AMENDMENT 3

On page 3, strikeout lines 3 through 6 and on line 7, strikeout "and Budget, 1997 edition"

#### AMENDMENT 4

On page 3, line 11, after "who" insert:

is engaged in work activities that are described in Codes 512110 and 512191 of the North American Industry Classification System Manual, published by the United States Office of Management and Budget, 1997 edition, and who